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Fed adopts rules on shady mortgage practices

Rules to restrict practices that have hurt borrowers in subprime market

BREAKING NEWS

The Associated Press

updated 9:20 a.m. MT, Mon., July. 14, 2008

WASHINGTON - The Federal Reserve has adopted rules to give home buyers more protection from the types of shady lending practices that have contributed to the housing crisis and propelled foreclosures to record highs.

Chairman Ben Bernanke and his central bank colleagues approved a plan Monday that would crack down on dubious lending practices that have hurt many of the riskiest "subprime" borrowers — people with tarnished credit histories or low incomes.

In that regard, the plan would:

- bar lenders from making loans without proof of a borrower's income.
- require lenders to make sure risky borrowers set aside money to pay for taxes and insurance. restrict lenders from penalizing risky borrowers who pay loans off early. Such "prepayment" penalties are banned if the payment can change during the initial four years of the mortgage. In other cases, a penalty can't be imposed in the first two years of the mortgage.
- prohibit lenders from making a loan without considering a borrower's ability to repay a home loan from sources other than the home's value. The borrower need not have to prove that the lender engaged in a "pattern or practice" for this to be deemed a violation. That marks a change — sought by consumer advocates — from the Fed's initial proposal and should make it easier for borrowers to lodge a complaint.

"Rates of mortgage delinquencies and foreclosures have been increasing rapidly lately, imposing large costs on borrowers, their communities and the national economy," Bernanke said.

"Although the high rate of delinquency has a number of causes, it seems clear that unfair or deceptive acts and practices by lenders resulted in the extension of many loans, particularly high-cost loans, that were inappropriate for or misled the borrower," he added.

For all mortgages, the plan would require advertising to contain additional information about rates, monthly payments and other loan features, and it would curtail certain deceptive or misleading advertising practices.

Other practices also would be clamped down on. Lenders, for instance, have to credit a mortgage payment to the homeowner's account on the day it is received. And, brokers and others are forbidden from "coercing or encouraging" an appraiser to misrepresent the value of a home.

Consumer groups initially complained that the new rules are not strong enough. Lenders worry they are too tough, could limit mortgage options for people and made it harder for some to obtain financing.

The new lending rules may not get a test for some time because there are fewer home buyers these days, given all the problems in the housing and credit markets. Also, some of the shady practices — along with some lenders — have not survived, felled by the mortgage meltdown.

"Clearly this is closing the barn door after the fact," said Susan Wachter, a professor of real estate and finance at the University of Pennsylvania's Wharton School of Business. Yet, she said, "this is a very important move. It absolutely will make a difference going forward."

Much will hinge on effective enforcement.

The plan would apply to new loans made by thousands of lenders, including banks and brokers. It would not cover current loans.

Those different lenders fall under a patchwork of regulators at the federal and state levels. So it will be up to each of these authorities to enforce the new provisions.

Fed Governor Randall Kroszner, the central bank's point person on the new rules, said the Fed's goal was to protect borrowers from unfair or deceptive practices while also not impeding the flow of credit.

The Fed's rules, he said, should "better protect consumers, while preserving their access to credit as they make some of the most important financial decisions of their lives."

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